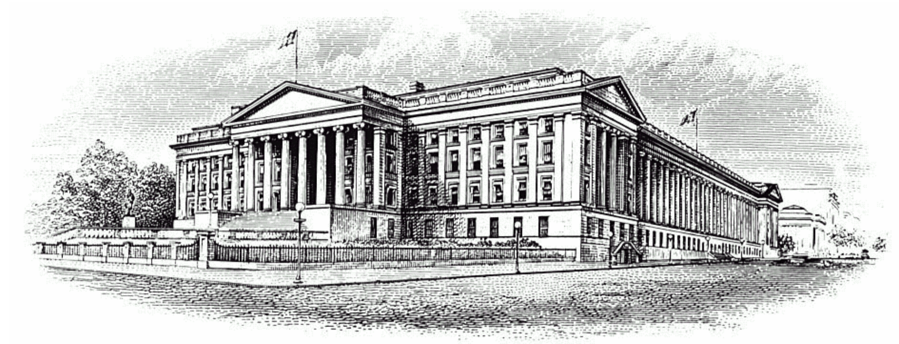

DEPARTMENT OF THE TREASURY
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Statement of
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House Committee on International Relations
Subcommittee on Africa, Global Human Rights and International Operations

Thank you Chairman Smith, Ranking Member Payne, and other members of the Subcommittee. I am very pleased to be here today to talk about the G8 Summit and Africa's Development from the perspective of the Treasury Department. I am particularly excited to brief you on the G8's decision to support the President's proposal for 100 percent debt cancellation for the poorest countries.

Before getting into the details, I would like to put this proposal into perspective. Since the beginning of President Bush's time in office he has pushed an aggressive agenda on development. This was first defined in the lead up to Monterrey, when the President proposed a New Compact for Development. This Compact was a proposal to increase aid, but with a clear purpose and in countries where it could be most effectively used to stimulate growth and reduce poverty. It was recognition that it's not enough to give more aid; we also needed to improve the way we deliver aid.

Historic Increases in Assistance…

Since Monterrey, we've seen an amazing evolution of U.S. official development assistance. While others are delivering promises, the U.S. has been delivering substantial increases. For some thirty years prior to this Administration, the U.S. provided roughly 15 percent of all official aid to Africa. Over the past two years the U.S. represented nearly a quarter of all official assistance to the continent. The increase has been dramatic, both in absolute terms and in terms of the U.S. share.

I should note that this dramatic increase in development assistance in recent years has come prior to disbursements from the President's Millennium Challenge Corporation (MCC) program. This year, the program is beginning to make disbursements and has billions of dollars in the pipeline. More importantly, this program is setting a new standard for delivering assistance to those countries that are helping themselves – by investing in the health and education needs of their people, fighting corruption, and demonstrating a commitment to economic freedom.

These increases also do not include the full implementation of the President's Emergency Plan for HIV/AIDS Relief. As of March 31st of this year, the Plan had already supported anti-retroviral drug treatment for approximately 230,000 men, women and children through bilateral programs in the most afflicted countries in Sub-Saharan Africa. This is a great start, but the goal is to treat some 2 million afflicted people in Africa, Asia and the Caribbean by 2008.

… with More Effective Delivery.

The manner in which aid is delivered is also changing dramatically. America has tried to change the focus of both our bilateral assistance and multilateral assistance away from simplistic numeric targets, and toward a greater focus on ensuring that assistance is well spent and channeled to environments where it can have the greatest possible impact in lifting people out of poverty.

For the Treasury Department, this has meant reforming the Multilateral Development Banks (MDBs) and the way in which they deliver assistance. As a result, the MDBs now deliver significantly more assistance to countries that are well governed and enact pro-growth policies. For example, the World Bank's International Development Association (IDA) now has one of the most selective systems for providing assistance of any donor, bilateral or multilateral, in the world. The Bank's strategy for FY06-08 envisions providing the top 10% of country performers with nearly 7 times as much assistance on a per capita basis as the lowest 10%, reflecting the heavy weight of governance in the allocation system. All of the MDBs with concessional windows -- with the exception of the GEF --have put similar systems in place as a result of strong U.S. leadership.

We have also been working to change the culture and standards by which the MDBs judge the effectiveness of their assistance. For many of these institutions, success was measured in the volume of loans going out the door. We are working to ensure that success is instead measured by measurable results on the ground. These efforts have already begun to pay dividends. For example the World Bank has now committed to have measurable targets for all country assistance strategies, all African Development Fund projects will have results-based frameworks, and the Asian Development Bank has begun instituting a performance review system that judges staff on project results. Also, as a result of strong U.S. leadership all of the MDBs now have independent evaluation units that are charged with examining the impact and effectiveness of their institutions' work and making the results publicly available.

Finally, we've worked to make sure that more assistance is given in the form of grants. It would be unwise, if not counter-productive, to continue to add to already unsustainable debt burdens in the poorest countries. Combined with our landmark agreement to cancel debt, the increased use of grants in the World Bank's IDA, Asian Development Fund (AsDF) and African Development Fund (AfDF) will ensure that poor countries do not find themselves again in the lend-forgive-lend trap. Due to strong U.S. leadership during the IDA-14 and AfDF-10 negotiations, there will be significantly more grants given to the poorest and most debt- vulnerable countries, including most Heavily Indebted Poor Countries (HIPCs).

A Bold Proposal – 100 Percent Debt Cancellation

For some forty years, many of the poorest countries have been getting loans for projects to support health, education and other basic development needs. Although the U.S. and most other countries now provide nearly all of their assistance to the MDBs in the form of grants, the banks continued to provide loans to the poorest countries in desperate need of development assistance. The result is that for many important projects without near-term financial returns, such as building schools, these poor countries were burdened with additional debt that needs to be repaid by future generations. Shifting to grants going forward ends this cycle. However, this alone would not have been enough. There also needed to be a correction of history, a cleaning of the balance sheets for future generations.

For many of the poorest countries, there has been a history of lend and forgive cycles. The HIPCs alone have accounted for nearly 250 debt relief treatments in the Paris Club over the last 25 years. This means that many countries have been getting debt reschedulings, or partial debt reduction, every two or three years. At the same time the MDBs have been increasing their lending volumes to fill up any space created by the temporary debt treatments. Between 1989 and 2002, debt relief to HIPC countries totaled $40 billion while new loans totaled more than twice that - $93 billion.

The international community has been pursuing a series of well intentioned, but ultimately stop-gap measures to address debt in the poorest countries. This started in 1979 with small amounts of relief, about $6 billion. In 1987, there was the establishment of "Venice terms" in the Paris Club whereby some countries would qualify for interest rate relief. This was followed by numerous rounds in the Paris Club of increasingly generous treatments (Toronto, London and Naples terms). Then in 1996, the HIPC Initiative, which for the first time incorporated debt relief from the international financial institutions, was announced. This was followed by the "Enhanced HIPC Initiative" in 1999. All of these initiatives helped to reduce the burden of debt in the poorest countries, yet the cycle of lend and forgive was still churning.

To end the cycle once and for all, the U.S. proposed a complete write-off of all official debt to the poorest countries. This included as much as $60 billion in HIPC countries' debt owed to the World Bank's IDA, the AfDF and the IMF.

I want to stress that many Members of Congress, including Members sitting in this subcommittee, along with representatives of civil society, have been extremely supportive and helpful in this campaign from the start. The U.S. has presented a very united front to the world on this issue, and that has been critical in convincing other countries to join us.

The Mechanics

The key to the U.S. proposal was to focus on the net flows from the institutions to the countries. As with our bilateral aid flows, the payments from the recipients are netted out from the new aid flows. Focusing on net transfers allows the proposal to maintain equity among the poorest countries. Under the HIPC initiative, HIPC countries received large increases in net transfers while non-HIPCs saw their net transfers decline. Focusing on the net flows was also important for cleaning the balance sheets of the MDBs. The International Financial Institutions were often giving loans to help ensure payment on old existing loans. This contributed to a lack of transparency and an exacerbation of the lend and forgive cycle.

When our ideas were first proposed nearly one year ago, they were met with considerable skepticism. This was primarily because they did not involve additional funding requests. With respect to the MDBs, we pointed out that the concessional windows are structured and funded such that they could forgive the debt of the HIPCs without impairing their ability to provide the same amount of net new funding for ongoing projects. Using 2003 as an example, we showed that the scale of reflows is small compared to disbursements. This is primarily because of the concessionality of IDA's financing and the significant nominal growth in disbursements over history. In 2003, the reflows from the HIPCs to IDA were roughly $200 million, compared to $3.4 billion in new disbursements. In fact, HIPC reflows accounted for only 3% of IDA's total new disbursements in 2003.

Though IDA lending represents the bulk of the remaining debt stock for HIPC countries, it was also important to have a strategy for IMF debt, which represents a significant portion of debt service in the short term given its much shorter repayment terms. In the IMF, many were calling for gold sales or off-market transactions. Significant work by our staff uncovered that there were existing resources within the Fund that could be used to effect debt relief. Moreover, this approach allows the fund to continue to engage effectively in low income countries while preserving its financial strength.

While the U.S. proposal ensured that net transfers to poor countries would not decline, many shareholders were worried about the long-term financial strength of the institutions. At the meeting between President Bush and Prime Minister Blair early this month, the United Kingdom agreed to support the U.S. proposal for 100 percent debt cancellation and the U.S. affirmed its commitment to the financial strength of the institutions. We will be able to do this by utilizing flexibility in the timing of payments of previously planned funding requests. Additional contributions will ensure the financial strength of the institutions, while being delivered based on performance, not historic debt obligations. This means that net transfers will in fact increase for countries that are performing well and using aid effectively.

The Historic Agreement

The agreement between Prime Minister Blair and President Bush was a critical breakthrough in the fight to cancel the debt for the poorest countries. This led to an agreement on June 11 by G8 Finance Ministers to a debt relief plan that largely reflects the one we began to discuss one year ago. As Treasury Secretary John Snow stated, "President Bush's commitment to lift the crushing debt burden on the world's poorest countries has been achieved. This is an achievement of historic proportions." The G8 Agreement calls for 100 percent cancellation of debt obligations owed to the World Bank (IDA), African Development Bank (AfDF), and International Monetary Fund by countries eligible for the HIPC Initiative.

The key elements of the G-8 agreement include:

- ***100 percent IDA, AfDF, and IMF Debt Stock Relief***. For IDA and AfDF debt, 100 percent stock cancellation will be delivered by offsetting gross assistance flows by the amount forgiven. IMF debt relief will be financed from existing IMF resources.

- ***Additional Donor Contributions to IDA and AfDF***. Donors will provide additional contributions, based on agreed burden shares, to offset foregone debt repayments (principal and interest) to IDA and AfDF. Additional funds will be made available immediately to cover the IDA-14 and AfDF-10 period and through regular replenishments for subsequent periods.

- ***Focus on Strong Performance***. The additional donor contributions will be allocated to all IDA-only countries based upon the existing IDA and AfDF performance-based allocation systems. This approach ensures equity between HIPCs and non-HIPCs – since all countries receive additional assistance commensurate with performance – and creates an incentive for countries to pursue responsible, pro-growth policies. Based upon existing performance levels, we estimate that roughly half of the additional contributions will be allocated to non-HIPC countries.

- ***Utilize grant financing from IDA and AfDF to ensure that countries do not immediately re-accumulate unsustainable external debts***. During this time period, HIPCs will gradually be eased into new borrowing based upon their capacity to repay. This transition period will enable countries to focus on developing the necessary environment for promoting economic growth and poverty reduction.

Under the plan, eighteen countries will be immediately eligible for IDA, AfDF, and IMF debt forgiveness: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia. The remaining HIPCs will also become eligible as they reach their HIPC Completion Point.

The total amount forgiven for the eighteen HIPC completion point countries will be $40.4 billion in nominal terms, of which IDA accounts for $32.9 billion, the AfDF $3.2 billion and the IMF $4.3 billion. The full application of the cancellation of existing debt repayments could amount to as much as $60 billion as countries complete the process.

Going Forward

The agreement by the G8 Finance Ministers this month was truly a historic occasion. That said, we still have significant work ahead. We will be presenting the proposal to the broader shareholders of the World Bank, AfDB and the IMF this fall to seek their agreement. We also need the support of Congress. The commitments to the financial strength of the institutions come first and foremost through our current and future appropriations requests. I would like to take this opportunity to thank the House of Representatives, following the lead of Subcommittee Chairman Kolbe and Ranking Member Lowey, for fully funding these requests for FY2006. This, however, is the first of many steps. It is my both my plea and my hope that we continue this close coordination among the Administration, Congress and civil society as we move forward in implementing this truly historic agreement.

I want to once again thank the subcommittee for giving me this opportunity to testify and for all the support for debt cancellation in the context of helping the poorest countries that are committed to pro-growth policies and poverty reduction.